

Message Text

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ACTION ARA-14

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-03

INR-07 NSAE-00 USIA-06 TRSE-00 XMB-02 OPIC-03

SP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-04

CEA-01 DODE-00 PM-05 H-01 L-03 PA-01 PRS-01

AGRE-00 ITC-01 /094 W

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R 101247Z AUG 77

FM AMEMBASSY BUENOS AIRES

TO SECSTATE WASHDC 1687

INFO AMEMBASSY ASUNCION

AMEMBASSY BRASILIA

AMEMBASSY MONTEVIDEO

AMEMBASSY SANTIAGO

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TAGS: ECON, EFIN, ELAB, EAGR, ETRD, AR

SUBJECT: ECONOMIC ALERT REPORT - ARGENTINA

REF: (A) STATE 180067, (B) BUENOS AIRES A-67

A. MAJOR ECONOMIC PROBLEMS

1. INFLATION

ARGENTINA'S MOST PRESSING ECONOMIC PROBLEM IS INFLATION. ALTHOUGH THE GOA HAS MADE CONSIDERABLE PROGRESS IN REDUCING THE ANNUAL RATE OF INFLATION FROM A LEVEL OF AROUND 600 PERCENT PREVAILING IN MARCH 1976 WHEN THE CURRENT GOVERNMENT ASSUMED POWER, ARGENTINA'S INFLATION RATE FOR FULL-YEAR 1977 IS EXPECTED TO BE IN THE RANGE OF 120-150 PERCENT -- STILL ONE OF THE HIGHEST IN THE WORLD. IN COMBATING INFLATION, THE GOA HAS USED A VARIETY OF MEASURES: WAGE

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CONTROLS; REDUCTION OF THE BUDGET DIFICIT; MODERATION IN THE EXPANSION OF THE MONEY SUPPLY; PRICE CONTROLS ON LEADING FIRMS; AND SELECTIVE REDUCTION IN TARIFFS IN AN EFFORT TO ESTABLISH A CEILING ON DOMESTIC PRICE LEVELS BY SUBJECTING LOCAL PRODUCTS TO FOREIGN COMPETITION. THE GOA HAS MADE IT CLEAR THAT ITS EFFORTS TO COMBAT INFLATION IN THE SECOND SEMESTER OF 1977 WILL BE

INTENSIFIED, PARTICULARLY THROUGH A TIGHT MONEY POLICY AND INCREASED TAX COLLECTION TO REDUCE THE BUDGET DEFICIT. (BA 5051, BA A-60, BA 5494.)

2. ECONOMIC RECESSION

THE VIDELA GOVERNMENT INHERITED AN ECONOMY IN RECESSION FROM THE PERONIST REGIME. IN VIEW OF ITS PRIORITY TO COMBAT INFLATION, THE GOA HAS HAD A DIFFICULT TASK IN BRINGING ABOUT A RECOVERY BUT DECLINE IN GDP WAS REVERSED IN THE FIRST SEMESTER AND GROWTH OF ABOUT 3-4 PERCENT IS EXPECTED FOR THE YEAR. MUCH OF THE RECOVERY, HOWEVER, IS ATTRIBUTABLE TO THE AGRICULTURAL SECTOR WHERE GOOD WEATHER AND SOUND GOVERNMENT POLICY COMBINED TO PRODUCE BUMPER CROPS AND RECORD EXPORTS. MANUFACTURING REMAINS RELATIVELY DEPRESSED, WITH FIRMS PRODUCING CAPITAL GOODS, INPUTS FOR AGRICULTURE, OR PROCESSING AGRICULTURAL PRODUCTION FARING BETTER THAN THOSE CATERING TO THE DOMESTIC CONSUMER MARKET.

3. REDUCED REAL WAGES

AS A RESULT OF OFFICIAL CONTROLS, THERE IS GENERAL CONSENSUS THAT REAL WAGES HAVE FALLEN -- ALTHOUGH THE EXTENT OF THE DECLINE IS SUBJECT TO INTENSE DEBATE. SOME TYPES OF WAGE EARNERS HAVE SUFFERED MORE THAN LIMITED OFFICIAL USE

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OTHERS, DEPENDING ON THE DEGREE TO WHICH EMPLOYERS HAVE OBSERVED GOVERNMENT-IMPOSED WAGE CEILINGS. WAGE CONTROLS HAVE LED TO SOME RESTIVENESS IN LABOR CIRCLES BUT THE GOA HAS THUS FAR MANAGED TO KEEP DISRUPTIONS AT A MINIMUM. WITH THE ECONOMY ON THE UPSWING, REAL WAGES ARE UNLIKELY TO DECLINE ANY FURTHER BUT NEITHER WILL THEY INCREASE AS FAST AS MOST PEOPLE WOULD LIKE. LABOR DISCONTENT THUS REMAINS A THREAT TO THE GOA AND COULD BE GALVANIZED BY A POLITICAL CRISIS. (BUENOS AIRES A-85 OF JUNE 29, 1977.)

4. STRUCTURAL DISTORTIONS

THE VIDELA ADMINISTRATION'S FREE MARKET ORIENTATION IS DESIGNED TO ELIMINATE OR REDUCE THE ECONOMIC DISTORTIONS INHERITED FROM THE PERONIST REGIME. IN THE PROCESS, SOME SECTORS WILL NECESSARILY SUFFER AT THE EXPENSE OF OTHERS. THE INDUSTRIAL SECTOR, AND IN PARTICULAR SMALL INEFFICIENT FIRMS CATERING TO THE DOMESTIC CONSUMER MARKET, WILL BE SUBJECTED TO INCREASING COMPETITIVE PRESSURES FROM ABROAD. THIS SECTOR, THEREFORE, REPRESENTS A POTENTIALLY DANGEROUS SOURCE OF OPPOSITION

TO THE CURRENT GOVERNMENT (BA 7628 OF NOV. 22, 1976).

B. OUTLOOK FOR THE NEXT TWELVE MONTHS

ASSUMING POLITICAL AND ECONOMIC CONTINUITY, THE

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ARGENTINE ECONOMY SHOULD CONTINUE TO REGISTER MODERATE GROWTH IN GDP OVER THE NEXT TWELVE MONTHS. THE INDUSTRIAL AND CONSTRUCTION SECTORS SHOULD RESPOND FAVORABLY OVERALL TO INCREASED PUBLIC AND PRIVATE SECTOR INVESTMENT. AGRICULTURAL PRODUCTION, ON THE OTHER HAND, IS EXPECTED TO DECLINE IN RELATION TO THE RECORD 1976/1977 CROP. THIS WILL AFFECT ADVERSELY FIRMS PROVIDING GOODS AND SERVICES FOR AGRICULTURE OR PROCESSING AGRICULTURAL PRODUCTION. LOWER GRAIN PRODUCTION AND PRICES, WILL ALSO PROBABLY REDUCE ARGENTINA'S EXPORTS IN 1978 IN RELATION TO 1977. WITH IMPORTS EXPECTED TO INCREASE AS A RESULT OF THE ECONOMIC RECOVERY, THE BALANCE OF TRADE SURPLUS ENJOYED BY ARGENTINA IN 1976 AND 1977 WILL PROBABLY BE GREATLY REDUCED OR ELIMINATED ALTOGETHER. ARGENTINA WILL THEREFORE HAVE TO DEPEND TO A GREATER DEGREE ON AN INFLOW OF NEW CAPITAL, ROLL OVER OF EXISTING DEBT, AND/OR DRAWDOWN OF ITS RESERVES TO MEET THE OVER ONE

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BILLION DOLLARS IN DEBT SERVICE PAYMENTS DUE IN 1978. CONTINUED PROGRESS MAY BE EXPECTED IN REDUCING THE BUDGET DEFICIT, THE EXPANSION OF THE MONEY SUPPLY, AND INFLATION.

C. CRITICAL POINTS

1. CHANGE IN POLITICAL OR ECONOMIC LEADERSHIP
WHILE PRESIDENT VIDELA AND MINISTER OF ECONOMY MARTINEZ DE HOZ HAVE WEATHERED VARIOUS CRISES AND APPEAR IN A STRONG POSITION, THEY BOTH HAVE ENEMIES WHO WOULD TAKE ADVANTAGE OF ANY POLITICAL OR ECONOMIC SETBACK TO REMOVE THEM. THE REMOVAL OF EITHER PRESIDENT VIDELA OR MARTINEZ DE HOZ COULD GREATLY UNDERMINE BUSINESS CONFIDENCE AND LEAD TO A CHANGE IN ECONOMIC ORIENTATION IF THEY WERE REPLACED BY POPULIST, STATIST, OR NATIONALIST INDIVIDUALS. SUCH A CHANGE WOULD PROBABLY REVERSE THE IMPROVEMENT IN THE CLIMATE FOR PRIVATE INVESTMENT (BOTH LOCAL AND FOREIGN), JEOPARDIZE PROGRESS MADE IN REDUCING PROTECTIONIST BARRIERS AND ECONOMIC DISTORTIONS, AND POSSIBLY LEAD TO BALANCE OF PAYMENTS DIFFICULTIES DUE TO CAPITAL FLIGHT.

2. WEATHER AND PRICES FOR AGRICULTURAL PRODUCTS
ARGENTINA IS HIGHLY VULNERABLE TO THE VARIABILITY OF WEATHER. AS INDICATED ABOVE, ARGENTINA CANNOT EXPECT TO BENEFIT DURING THE SECOND HALF OF 1977 FROM THE ALMOST IDEAL WEATHER CONDITIONS EXPERIENCED IN LATE 1976 AND EARLY 1977 AND THEREFORE SOME REDUCTION IN THE ECONOMIC CONTRIBUTION FROM THE AGRICULTURAL SECTOR MAY BE EXPECTED IN 1978. SHOULD POOR WEATHER CONDITIONS PREVAIL DURING THE REST OF 1977, ARGENTINA'S ECONOMY AND ABOVE ALL EXPORTS WOULD SUFFER A SERIOUS BLOW --
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PARTICULARLY SINCE WORLD PRICES FOR GRAINS ARE EXPECTED TO BE LOW.
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